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C O N F I D E N T I A L SECTION 01 OF 03 ALGIERS 001918

SIPDIS

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TAGS: [ECON](#) [ENRG](#) [EPET](#) [AG](#)

SUBJECT: DEMARCHE DELIVERED ON RESPONDING TO ENERGY SUPPLY
DISRUPTIONS

REF: STATE 163206

Classified By: Ambassador Richard W. Erdman,
for reasons 1.4 (b) and (d)

SUMMARY

1. (C) Ambassador delivered reftel demarche concerning post-Katrina energy supply disruptions, as well as longer term conservation measures, to Minister of Energy and Mines Khelil September 11. Khelil said the shortage of refining capacity was a large contributing factor to current petroleum shortages and that refining capacity would be not be sufficiently augmented in the near future. Algeria was working to increase its refining capacity, but the bigger problem globally was that producers did not want to invest in new production because the rate of return was low, the risks were high, and they would not be able to refine the additional product. Investments in exploration for new reserves have been slow to follow price hikes because suppliers have been thinking price spikes were temporary. Only now are they concluding significantly higher prices, compared to those of recent years, are here to stay. Algeria expected to produce 1.4 million barrels of oil in 2005 and 1.5 million in 2006. Natural gas production exceeded targets.

2. (C) The new hydrocarbon law was having a positive effect, but the new independent regulatory agency was only now being set up and it would take about five years before new fields were explored under the new law's parameters. Finally, Khelil noted Algerian dissatisfaction with the bidding process for new projects in Libya, which Khelil termed not credible and subject to corruption. (End Summary.)

3. (C) Ambassador, accompanied by PolEc Chief, delivered reftel demarche September 11 on responding to energy supply disruptions in the aftermath of Hurricane Katrina to Minister of Energy and Mines Khelil. Leaving behind a non-paper, Ambassador stressed the short-term actions the United States has taken to shore up supply and the long-term actions taken to promote energy conservation. In response, Khelil said Katrina was a temporary problem that affected production facilities in the Gulf of Mexico and on shore. The release of oil from U.S. strategic reserves and the additional provision of petroleum by the International Energy Agency (IAE) were "good calming influences" on the markets. That is the reason reserves were set aside.

SHORTAGE OF REFINING CAPACITY

4. (C) The lack of maintenance on refineries was a large contributing factor to the current shortage, said Khelil. To keep pace with demand, refiners were postponing needed maintenance, leading to breakdowns. The problem would likely be exacerbated as refineries began to produce relatively more fuel oil, and relatively less gasoline, for the winter months. The postponement of maintenance in order to keep pace with demand for petroleum products was a problem three months before Katrina struck. There would be a continued shortage of refining capacity for the foreseeable future, predicted Khelil.

5. (C) According to Khelil, Algeria was working to increase its refining capacity. Construction of a new refinery at Adrar was almost finished; construction had just begun on a second at Skikda; and construction of a third refinery at Tiaret was planned. The first two refineries would turn out 100,000 barrels of oil per day, while the third would turn out three times that amount. The issue was not one of production but rather one of refining capacity. The constraints on refining erected a bottleneck in the distribution system. Either refining capacity needed to be increased or global demand reduced to prevent continue increases in petroleum prices. The latter was unlikely with economic growth in China, at 9.5 percent, stronger than had been predicted a year ago. Despite Katrina, added Khelil, the U.S. economy was still strong. Demand, therefore, would be maintained.

PRODUCERS UNWILLING TO INVEST IN EXPANDING PRODUCTION

16. (C) Ambassador asked for Khelil's views on pricing in such a climate. Khelil said refining constraints established the price, and breakdowns in equipment led to price spikes. The current future market price of crude oil was \$65 for delivery in March 2006. The dilemma was that the cycle formed a vicious circle. Producers did not want to invest in new production because they would not be able to refine the additional product. At the same time, they did not want to invest in refining capacity because the rate of return in that sector was low. Of course, the lack of refining capacity led to still higher prices for consumers.

17. (C) Investments in exploration for new reserves have been slow to follow price hikes, explained Khelil, because suppliers thought spikes were only temporary. Five years ago, no one thought high oil prices were sustainable. Ambassador asked if the mind-set had changed. Khelil thought companies were purchasing their shares of stock rather than investing in expanding production. There was much rhetoric about increasing OPEC production, but with existing technologies there was cause for additional investments in production.

ALGERIA A YEAR BEHIND OIL PRODUCTION TARGET, AHEAD IN GAS

18. (C) Ambassador asked the Minister if Algeria was on target for its own production goals. Khelil said Algeria was producing 1.4 million barrels of oil this year and was on track to produce 1.5 million barrels in 2006. Algeria was one year behind in attaining its oil target. In natural gas, however, Algeria had exceeded its targets in production capacity. A new underwater pipeline to Spain was expected to be usable in 2008. The Tunisians were looking to expand the capacity of the pipeline to Italy, and the Government of Tunisia had given its okay to approve shipping contracts to Italian companies. Construction contracts had been finalized for a pipeline from Tunisia to the Italian mainland via Sardinia. Italy imported about 25 percent of its natural gas from Algeria.

IMPLEMENTATION OF RECENTLY PASSED HYDROCARBON LAW

19. (C) Ambassador asked Khelil if the implementation of the new hydrocarbon law had affected Algerian behavior. Khelil said the state-owned energy company, Sonatrach, had already made adjustments in the way it did business. It had, for example, identified what clearances were needed for new pipeline routes. Obtaining the clearances caused the Government to delay publishing the law until the pipeline routes were established, but the new procedures in the long run would increase efficiency and government revenues. President Bouteflika had been asked to approve the establishment of five regulatory agencies: two for mining, two for hydrocarbons, and one for electricity/gas. It would take 3-4 years to make the system work efficiently and 4-5 years before new fields were explored under the parameters of the new law.

110. (C) Asked by Ambassador for additional impacts on Sonatrach, Khelil explained that the state-owned firm would need from now on to sign a contract for each field just like any other company. It would be held accountable for costs and profits from each field rather than from total production. Sonatrach would no longer be able to cover losses in some fields from profits in others. This would increase both efficiency and tax revenues. Asked if recent suspensions of Sonatrach personnel for alleged corrupt activities had a positive impact, Khelil said the suspensions were not the first of their kind. Since the Government was suing companies found not to have followed established procedures and such matters were before the courts, Khelil declined to provide additional information.

U.S. HUMANITARIAN PROJECT IN OUARGLA GOOD FOR ALL

111. (C) Ambassador briefed Khelil on a project approved by U.S. authorities (note: EUCOM) for which the Embassy was waiting for \$500,000 in USG funding that we hoped to leverage with private sector money for humanitarian purposes. The project, explained Ambassador, had the support of the wali of Ouargla and called for the construction of a community center that would increase the skills of area workers and help to alleviate unemployment. Microsoft would train instructors for the unemployed; Anadarko would furnish equipment and contribute toward the start-up costs; and Nabors Drilling would contribute to covering the personnel costs. The goal, explained Ambassador, was to increase the pool of employable people by teaching English and computer skills. This would benefit the people and the oil companies, which needed speakers of French and English. We envisioned the establishment of a fitness center, library, and Internet center.

12. (C) Khelil praised the idea and noted that the GOA was focusing on educating girls in the south of the country. The emphasis was on educating girls, explained Khelil, because they were disadvantaged compared to boys. Ambassador commented that he had been struck that the best workers were often women but that, for cultural reasons, it was hard to reward the added productivity of female workers with higher salaries. Khelil agreed that rewarding efficiency was a big problem in the Algerian economy, which continued to have an egalitarian cultural outlook. This was true in Sonatrach, where a new system was being implemented to reward group performance. Each work group competed with others and was rewarded as a group based on performance. This added a powerful incentive to team leaders, not to mention the workers themselves.

COMPLAINTS ABOUT HYDROCARBON PROJECTS IN LIBYA

13. (C) Asked by Ambassador about doing business with Libya, Khelil complained that the bidding process for projects in Libya was not credible. Occidental recently won 9 blocks with one partner; Algeria one block; and none for the Europeans. Khelil made clear he was not criticizing U.S. companies but rather the lack of credibility in the Libyan bidding process. The rules were not equally applied. Sonatrach, for example, was forbidden from bidding in conjunction with a foreign partner because, the Libyans had explained, Algeria was an Arab country and could not bid with "foreigners." Paying off key people was sufficient to have a block rewarded. Sonatrach did not play that game, stressed Khelil. Nor by U.S. law could U.S. firms, added Ambassador.

14. (C) Ambassador inquired about Algerian participation in the Libyan natural gas sector. Khelil said Algeria held an 11 % stake in new upstream investments, 22% in pipelines. In addition, Algeria was making money from existing operations in Libya.

ERDMAN